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SUBJECT: UKRAINE: VANCO CASE SENT TO CONSTITUTIONAL COURT,
NEITHER SIDE BACKING DOWN

REF: KYIV 1145

Classified By: By Ambassador for reasons 1.4 (b), (d)

¶1. (SBU) On June 18, Ukrainian President Viktor Yushchenko issued a decree aimed at suspending the Cabinet of Ministers (CabMin) resolution which annulled the production sharing agreement (PSA) with Vanco. Yushchenko's decree temporarily suspends the CabMin resolution only until the Constitutional Court rules on the constitutionality of the CabMin action. In the decree, Yushchenko cited article 17 of the Constitution, which pertains to Ukraine's energy security. Yushchenko charged that by annulling the PSA with Vanco, the CabMin had jeopardized Ukraine's ability to provide for its energy security and had delayed crucial hydrocarbon exploration of the Black Sea for many years to come. Previous to Yushchenko's decree, the National Security and Defense Council had called for the CabMin to rescind its resolution and seek an amicable solution with Vanco (reftel).

¶2. (C) The presidential decree does not overturn the CabMin resolution, but only refers it to the Constitutional Court in accordance with Ukraine's constitution. The Court must now rule whether the CabMin overstepped its bounds in canceling the PSA and thereby acted unconstitutionally. (Comment: Since a ruling from the Constitutional Court could take months, the decree does provide the government and Vanco with some additional time to rethink their positions before July 8, the day Vanco can legally file for international arbitration in accordance with Ukraine's PSA law. However, at the same time any exploration activity will remain on hold.)

¶3. (SBU) On June 19, First Deputy Prime Minister Oleksandr Turchynov responded to the Presidential decree in the press, announcing that the Interagency Commission convened by the CabMin had found that the PSA was revoked in a legitimate and legal manner. Turchynov added that the Interagency Commission also found that the cancellation of Vanco's operating license by the Ministry of Environmental Protection on April 25 was a legal and legitimate act. Vanco publicly criticized Turchynov's comments, and applauded the Presidential decree, calling it a logical step in resolving the on-going conflict.

¶4. (SBU) While Prime Minister Yuliya Tymoshenko continues to insist that the GOU will win any upcoming court decisions, First Deputy Head of the Presidential Secretariat Oleksandr Shlapak stated in the press that Ukraine had very little chance of winning should the conflict be resolved by an international court. Local legal experts, including those who helped draft the current PSA law, agree that Vanco currently has the upper hand if it chooses to pursue international arbitration.

¶5. (C) Vanco's representative in Ukraine, Jim Bown, told EconCouns that he had recently been named President of Vanco Prykerchenska. (Note: Jim Bown had previously acted officially as a consultant to Vanco, although he has been actively involved in the PSA since the tender was announced in 2005. End note.) Bown also told EconOff that rumors Vanco would replace some of its investors with those more palatable to PM Tymoshenko were unfounded. Vanco and the other investors were confident of a victory in arbitration, which could amount to billions of dollars, he said. Bown also reaffirmed that Vanco would not renegotiate the PSA, as Tymoshenko is demanding, although he indicated, without being specific, that Vanco and the other investors were still somewhat open to a compromise. Otherwise, he said, Vanco's only option would be to say, "See you in Stockholm," referring to the presumed location for international arbitration proceedings.

TAYLOR